No. 09-1

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

DEANNA McBREARTY and MARYLYNN HARTSEL, individually, derivatively, and on behalf of all others similarly situated,

Petitioners,

v.

THE VANGUARD GROUP, INC., GEORGE U. SAUTER, DUANE F. KELLY, JOHN J. BRENNAN, CHARLES D. ELLIS, RAJIV L. GUPTA, AMY GUTMANN, JOANN HEFFERNAN HEISEN, ANDRE F. PEROLD, ALFRED M. RANKIN JR., J. LAWRENCE WILSON, ACADIAN ASSET MANAGEMENT, LLC, RONALD D. FRASHURE, JOHN R. CHISHOLM, BRIAN K. WOLAHAN, MARATHON ASSET MANAGEMENT, LLP, NEIL M. OSTRER, VANGUARD INTERNATIONAL EQUITY INDEX FUNDS, d/b/a VANGUARD EUROPEAN STOCK INDEX FUND, and VANGUARD HORIZON FUNDS, d/b/a VANGUARD GLOBAL EQUITY FUND,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

THOMAS I. SHERIDAN, III*
ANDREA BIERSTEIN
HANLY CONROY BIERSTEIN
SHERIDAN FISHER & HAYES, LLP
112 Madison Avenue
New York, NY 10016-7416
(212) 784-6404
tsheridan@hanlyconroy.com
abierstein@hanlyconroy.com

* *Counsel of Record* — *Attorneys for Petitioners*

QUESTIONS PRESENTED

Respondents are mutual fund managers who knowingly purchased stock in offshore gambling entities that illegally earned nearly 90% of their revenues from gamblers in the United States. The mutual funds suffered massive losses following law enforcement in the U.S. against the illegal gambling businesses that choked off their primary source of revenue and lead to the forfeiture of almost $650 million in criminal proceeds. Respondents' unlawful investments violated 18 U.S.C. § 1955 ("§ 1955"), which makes it illegal to "own all or part of an illegal gambling business." A violation of § 1955 is a predicate crime under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961(1) ("RICO"). Petitioners sued on behalf of the mutual funds under RICO, alleging that the investment losses had been "the foreseeable, direct and natural consequences of [Respondents'] unlawful investments in illegal gambling businesses" and thus had been "proximately caused by [Respondents'] racketeering activities." The Court of Appeals for the Second Circuit affirmed the dismissal of Petitioners' RICO claims as a matter of law, holding that the complaint failed to allege proximate causation.

Three questions are presented:

1. Does a reasonably foreseeable intervening cause (in this case, government enforcement of criminal laws) sever proximate causation under RICO? The Court of Appeals held that it does. Under *Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. 639, 128 S. Ct. 2131 (2008), it does not.

2. May lower courts dispense with the proximate cause enquiry required by *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258 (1992), in favor of a mechanical, black-letter rule that "proximate causation is lacking under RICO when the harm results from the exposure or disclosure of the RICO predicate activity"? The Court of Appeals accepted that all three *Holmes* factors weighed in Petitioners' favor and that Petitioners' injuries had been reasonably foreseeable consequences of Respondents' racketeering but nevertheless affirmed the dismissal of Petitioners' RICO claims.

3. Where the plaintiff alleges a direct "first step" injury not contingent on harm suffered by a third-party from the racketeering activity, does RICO impose a proximate cause requirement that is stricter than at common law? The Court of Appeals held that it does.

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OPINIONS BELOW

The order of the United States Court of Appeals for the Second Circuit entered November 23, 2009, appears in the appendix at pp. 1-5. It is not officially reported but is available on Westlaw. *McBrearty v. Vanguard Group, Inc.*, No. 09-1445-cv, 2009 WL 4019799 (2d Cir. Nov. 23, 2009).

The order of the Court of Appeals denying rehearing and rehearing *en banc* entered January 12, 2010, appears in the appendix at pp. 16-17 and is unreported.

The memorandum and order of the United States District Court for the Southern District of New York entered April 6, 2009, appears in the appendix at pp. 6-15. It is not officially reported but is available on Westlaw. *McBrearty v. Vanguard Group, Inc.*, No. 08 Civ. 7650, 2009 WL 875220 (S.D.N.Y. Apr. 2, 2009).

JURISDICTION

The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

The order sought to be reviewed was entered on November 23, 2009. The order denying rehearing was entered January 12, 2010.

The District Court possessed subject matter jurisdiction under 28 U.S.C. § 1331 (federal question), 1337 (commerce regulation), and 1367(a) (supplemental jurisdiction) and under 18 U.S.C. § 1964 (RICO).

The Court of Appeals possessed appellate jurisdiction pursuant to 28 U.S.C. § 1291 (final decision). Final judgment was entered on April 6, 2009. Petitioners timely filed their notice of appeal to the Court of Appeals on April 8, 2008.

STATUTES INVOLVED

18 U.S.C. § 1964(c) provides, in pertinent part:

> Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court . . . .

18 U.S.C. § 1962(c) provides:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

18 U.S.C. § 1961(1) provides, in pertinent part:

> "racketeering activity" means . . . (B) any act which is indictable under any of the following provisions of title 18, United States Code: . . . section 1955 . . . .

18 U.S.C. § 1955(a) provides:

Whoever conducts, finances, manages, supervises, directs, or owns all or part of an illegal gambling business shall be fined under this title or imprisoned not more than five years, or both.

18 U.S.C. § 1955(b)(1) provides:

> "illegal gambling business" means a gambling business which—
>
> > (i) is a violation of the law of a State or political subdivision in which it is conducted;
> >
> > (ii) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and
> >
> > (iii) has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of $2,000 in any single day.

STATEMENT OF THE CASE

Petitioners are investors in two Vanguard mutual funds. Respondents, the fiduciaries who managed and advised the funds, knowingly caused the funds to make substantial investments in offshore Internet gambling entities whose principal source of revenue was from gamblers in the U.S., in violation of U.S. anti-gambling laws.[1] The foreign gambling companies were "illegal gambling businesses" as that term is defined in § 1955(b). They and their principals have since forfeited to the federal government almost $650 million in criminal proceeds. Their founders have pleaded guilty to criminal offenses subjecting them to significant fines and prison sentences.

Section 1955(a) provides that whoever "owns all or part of an illegal gambling business" is guilty of a felony. By causing the mutual funds to purchase stock in illegal gambling businesses, Respondents caused the mutual funds to own part of such businesses in violation of § 1955. A violation of § 1955 is a predicate crime under RICO. 18 U.S.C. § 1961(1). By purchasing shares in illegal gambling businesses repeatedly and over a significant period of time, Respondents conducted the affairs of the mutual funds through a "pattern of racketeering" in violation of RICO. 18 U.S.C. § 1962(c).

In making the unlawful investments, Respondents took a reasonably foreseeable risk that the mutual funds

1. The mutual funds on whose behalf Petitioners sue are nominal defendants and respondents, but they are not included within the term "Respondents" as used in this Petition.

would suffer losses should law enforcement authorities prosecute and force the illegal gambling businesses to stop violating U.S. anti-gambling laws. The gambling companies *actually warned* Respondents in their prospectuses that they violated U.S. criminal statutes. For example, one of the foreign gambling companies disclosed to Respondents that "the US Department of Justice considers that companies offering online gaming to US residents are in violation of existing US federal laws," but Respondents invested anyway. The same gambling company explicitly warned Respondents that law enforcement "could result in investors losing all or a very substantial part of their investment." That is exactly what happened. Following a law enforcement crackdown spearheaded by the United States Department of Justice aimed at illegal Internet gambling, the mutual funds suffered significant investment losses as the share prices of the foreign gambling entities plummeted in the foreign markets in which they traded to reflect the loss of their primary source of revenue.*

Petitioners brought this derivative action under RICO, on behalf of the mutual funds, to recover for the investment losses that the mutual funds suffered as the direct and reasonably foreseeable result of Respondents' unlawful investments in illegal gambling businesses.

The District Court dismissed Petitioners' RICO claims for failure to allege proximate causation. Disregarding the three factors relied on by the Court in *Holmes* and its progeny, the District Court held that (i) the mutual funds' investment losses had been proximately caused not by Respondents' illegal investments, but rather by the "intervening" actions of the government in enforcing anti-gambling and racketeering laws; and (ii) Petitioners "were not the intended victims or targets" of Respondents' racketeering activities. (14a)

* The shares were not traded in the U.S. due to the illegality.

The Court of Appeals for the Second Circuit affirmed, saying:

> [t]he decline in the funds' online gambling holdings was not the direct result of the RICO violation – the owning and/or financing of illegal gambling – but rather was the result of the subsequent "government crackdown" on the illegal gambling. Although plaintiffs contend that the law enforcement crackdown was a foreseeable risk of defendants' activities (rather than a supervening cause), we have already held that proximate causation is lacking under RICO when the harm results from the exposure or disclosure of the RICO predicate activity. *In re Am. Express Co. S'holder Litig.*, 39 F.3d 395, 400 (2d Cir. 1994).

(4a)

In a footnote, the Court of Appeals held that RICO proximate causation is more demanding than what is required at common law, so as to render foreseeability immaterial:

> Although foreseeability is often the test of proximate causation at common law, *see Palsgraf v. Long Island R.R. Co.*, 162 N.E. 99, 100 (N.Y. 1928), RICO causation is a concept distinct from "proximate causation as that term is used at common law." *Abrahams v. Young & Rubicam Inc.*, 79 F.3d 234, 237 (2d Cir. 1996).

(4a n.1)

Like the District Court, the Court of Appeals also refused to conduct the proximate cause inquiry using the three factors relied on by the Court in *Holmes*. Neither the District Court nor the Court of Appeals has ever identified even a single *Holmes* factor that weighs against a finding of proximate causation in this case. Nevertheless, the Court of Appeals held that "even assuming *arguendo* that [the *Holmes*] policy considerations cut in plaintiffs' favor, they cannot remedy the basic defects in causation . . . ." (4a)

REASONS FOR GRANTING THE PETITION

I. The Writ of Certiorari Should Be Granted to Determine Whether Reasonably Foreseeable Intervening Events Insulate Racketeers from Civil Liability Under RICO

The Court of Appeals refused to consider basic common law principles in evaluating the significance of intervening causes under RICO and thus decided an important question of federal law contrary to the relevant decisions of the Court. Sup. Ct. Rule 10(c). The decision below also conflicts with the decisions of other Courts of Appeals on the same important matter. Sup. Ct. Rule 10(a). The undisputed facts of this case also afford an opportunity for the Court to resolve legal issues left unsettled by *Hemi Group, LLC v. City of New York*, 130 S. Ct. 983 (Jan. 25, 2010).

In *Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. 639, 128 S. Ct. 2131 (2008), the Court held that defendants' racketeering activities proximately caused the plaintiffs' RICO injuries even though contributing

causes – including government action – had intervened between the defendants' RICO violations and the plaintiffs' injuries. The plaintiffs and defendants in *Bridge* were competing buyers at a public auction. The defendants allegedly committed mail fraud by submitting false certifications to the government authorities conducting the auction. The false certifications misled government authorities concerning the identities of the defendants and the agents bidding on their behalf. The government authorities consequently awarded to the defendants a greater percentage of auction sales when the plaintiffs and defendants submitted equal bids. Despite the governmental action that had intervened between the defendants' fraud and the plaintiffs' injuries, the Court held that the RICO violations proximately caused the plaintiffs' injuries.

The Court said that the government's actions in permitting the defendants to participate in the auction had been the "foreseeable and natural consequence" of the fraud, 128 S. Ct. at 2144, and therefore had *not* been "an intervening cause breaking the chain of causation." *Id.* That holding is entirely consistent with well-established common law principles of causation.

At common law, certain intervening events – also called "superseding causes" – may sever the causal nexus between a defendant's wrongdoing and a plaintiff's injury. This occurs, however, only if the injury is neither reasonably foreseeable nor part of the risk created by a defendant's wrongful conduct. *See, e.g.*, *Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 837 (1996) ("'The doctrine of superseding cause is . . . applied where

. . . the injury was actually brought about by a later cause of *independent origin that was not foreseeable*'") (emphasis added)), *quoting* 1 T. Schoenbaum, *Admiralty and Maritime Law* § 5-3, pp. 165-166 (2d ed. 1994).

A later cause can supersede the original cause only if it is independent of the original cause. *See, e.g., Aetna Ins. Co. v. Boon*, 95 U.S. 117, 130 (1877). For a cause nearer in time to be an "independent" cause – or, to use the terminology of *Anza v. Ideal Steel Supply Corp.*, 547 U.S. 451, 458 (2006), for it to be "entirely distinct" so as to cut off liability – it must be neither reasonably foreseeable nor part of the risk created by the defendant's wrongful act. As Judge Friendly explained, "not every new force insulates a negligent defendant from liability or a plaintiff guilty of contributory fault from the consequences. The principle is limited to 'intervening causes which could not reasonably be foreseen, and which are no normal part of the risk created.'" *East Hampton Dewitt Corp. v. State Farm Mut. Auto. Ins. Co.*, 490 F.2d 1234, 1240 (2d Cir. 1973), *quoting* W. Keeton, D. Dobbs, R. Keeton & D. Owen, *Prosser and Keeton on Law of Torts* § 44, p. 281 (5th ed. 1984) [hereinafter *Prosser & Keeton*]. *Accord Bonsignore v. City of New York*, 683 F.2d 635, 638 (2d Cir. 1982), *quoting Derdiarian v. Felix Contracting Corp.*, 51 N.Y.2d 308, 316 (1980).

Not even the intentional or criminal act of a third-party is sufficient to break a causal chain where the intervening act is reasonably foreseeable. *See Lillie v. Thompson*, 332 U.S. 459, 462 (1947) (*per curiam*); *Hemi*, 130 S. Ct. at 998 (Breyer, *J.*, dissenting). *See also Preston*

v. Cauldwell-Wingate Co., 176 F.2d 237, 241 (2d Cir. 1949) (L. Hand, *J.*) ("it is not the law of New York that the intervention of a succeeding fault as such gives immunity to an earlier wrongdoer"); *Horan v. Watertown*, 217 Mass. 185, 186, 104 N.E. 464, 465 (1914).

Refusing to follow *Bridge* and established common law principles, the Court of Appeals held that, in the RICO context, even reasonably foreseeable intervening events – here, government enforcement of criminal statutes – are sufficient to insulate racketeers from civil liability. (4a) This was error. The refusal of the Court of Appeals to apply basic common law principles in determining whether an intervening event constitutes a "supervening cause" under RICO cannot be reconciled with *Bridge* or with decisions of other Courts of Appeals. *See, e.g., Mid Atlantic Telecom, Inc. v. Long Distance Servs., Inc.*, 18 F.3d 260, 263-64 (4th Cir. 1994) ("[t]aking the complaint at face value, it cannot be said that we are confronted with circumstances . . . where the intervening acts were wholly independent of the alleged [RICO] predicate acts."); *Cox v. Admin. United States Steel & Carnegie*, 17 F.3d 1386, 1399 (11th Cir. 1994) (where defendant's racketeering activity was a "substantial factor" in causing the harm, the existence of a contributing cause was "beside the point"), *citing Prosser & Keeton* § 41, at 268 ("If the defendant's conduct was a substantial factor in causing the plaintiff's injury, it follows that he will not be absolved from liability merely because other causes have contributed to the result, since such causes, innumerable, are always present").

By ignoring basic common law concepts, the decisions below effectively require that a RICO plaintiff's injury be caused by only one source. This conflicts with decisions of other Courts of Appeals. As the Eleventh Circuit has explained, "[i]n both federal RICO and federal antitrust cases, 'proximate cause is not . . . the same thing as sole cause,' and it is enough for the plaintiff to plead and prove that the defendant's tortious or injurious conduct was a 'substantial factor in the sequence of responsible causation.'" *Williams v. Mohawk Indus., Inc.*, 465 F.3d 1277, 1288 n. 5 (11th Cir. 2006), *citing Cox*, 17 F.3d at 1399. *See also, Oki Semiconductor Co. v. Wells Fargo Bank, Nat. Ass'n*, 298 F.3d 768, 773 (9th Cir. 2002) (relying on "substantial factor" test).

The Court's antitrust decisions confirm that reasonably foreseeable intervening events do not insulate a defendant from liability so long as the defendant's wrongdoing is a material cause of the plaintiff's injury.[2] In *Blue Shield of Virginia v. McCready*, 457 U.S. 465, 480 n.17 (1982), the Court found that a subsequent event that "contributed" to the plaintiff's injury did not break the sequence of responsible causation. Similarly, in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 114 n. 9 (1969), the Court held that it is "enough that the illegality is shown to be a material cause . . . a plaintiff need not

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2. The Court often looks to antitrust precedent for guidance when addressing RICO issues. *See Holmes*, 503 U.S. at 272; *Anza*, 547 U.S. at 477 (Thomas, *J.*, concurring in part and dissenting in part); *Agency Holding Corp v Malley-Duff & Assoc's Inc*, 483 U.S. 143, 150 (1987).

exhaust all possible alternative sources of injury in fulfilling his burden of proving compensable injury under § 4 [of the Clayton Act]." *See Hasbrouck v. Texaco, Inc.*, 842 F.2d 1034, 1042-45 (9th Cir. 1987) (intervening causes did not break the chain of causation).

Given the weight of the foregoing authority, the question raised in dissent by Justice Breyer in *Hemi* is particularly apt here: Where "so much basic common law argues in favor of [a finding that proximate cause exists], how can the Court avoid that conclusion here?" 130 S. Ct. at 998 (Breyer, *J., dissenting*).

Unless the Court clarifies the law in this area, the decision below will operate in this and other cases to insulate from liability defendants who inflict significant injury in violation of RICO.[3] While the Court may have hoped to clarify the law in this area when it granted certiorari in *Hemi*, that case failed to produce an

3. Other mutual fund managers who unlawfully invested in illegal offshore gambling businesses have successfully relied on the precedent of the decision below in their attempt to cut off recovery of hundreds of millions of dollars in damages for thousands of innocent investors in other widely-held funds. *See Wodka v Causeway Capital Mgmt., LLC*, 09-cv-02625 (C.D. Cal. Oct. 9, 2009), *appeal pending*, 09-56733 (9th Cir. Nov. 5, 2009); *Seidl v Am. Century Cos , Inc* , No. 08-cv-08857 (S.D.N.Y. Apr. 28, 2009). The rule of decision applied in this case may also affect the rights of investors in other mutual funds in cases that have yet to be filed. *See generally* M. Ritchel, *Wall St Bets on Gambling on the Web*, N.Y. Times, Dec. 25, 2005 (the problem of U.S. funds investing in illegal gambling was widespread and merited the attention of Congress with calls for a formal Congressional investigation).

authoritative decision.[4] The plurality and dissenting opinions in *Hemi* express sharply differing views concerning the relevance of the common law concept of foreseeability in RICO cases. The undisputed facts of this case afford an opportunity for the Court to clarify for the lower courts the law of intervening causes in the RICO context.

II. The Writ of Certiorari Should Be Granted to Resolve a Split in the Circuits Regarding Whether the Proximate Cause Enquiry Required by *Holmes* May Be Disregarded in Favor of a Mechanical Test

The Court of Appeals refused to conduct the proximate cause enquiry using *any* of the three factors relied on by the Court in *Holmes*. (5a) Its decision

4. The plurality opinion in *Hemi* is not an authoritative determination for other cases because of "the lack of an agreement by a majority of the Court on the principles of law involved." *United States v Pink*, 315 U.S. 203, 216 (1942), *citing Hertz v. Woodman*, 218 U.S. 205 (1910); *see Marks v. United States*, 430 U.S. 188, 193-94 (1977). Justices Breyer, Stevens, and Kennedy expressly disagreed with the plurality view and dissented. The dissenting Justices argued that the "directness" requirement *expands* RICO liability *beyond* what is foreseeable. 130 S. Ct. at 998 (Breyer, *J., dissenting*). Justice Ginsburg concurred with the result but expressly refused to subscribe to the plurality's proximate cause analysis and voted to reverse the case on other grounds. Justice Sotomayor did not participate. She had been a member of the panel that had decided the case in the Court of Appeals. As Petitioners explain in Section III below, the reasoning of the plurality in *Hemi* would not require the dismissal of Petitioners' complaint because Petitioners complain of a direct "first step" injury.

therefore conflicts with the decisions of the Court and other Courts of Appeals on the same important matter. Sup. Ct. Rule 10(a), (c).

Under *Holmes*, questions of RICO proximate causation are resolved by weighing three factors:

i. Whether it will be difficult to ascertain the amount of plaintiff's damages attributable to defendant's wrongful conduct as distinct from other, independent, factors. 503 U.S. at 269.

ii. Whether the court would be forced to adopt complicated rules apportioning damages to obviate the risk of multiple recoveries. *Id.*

iii. Whether there are more directly injured victims who could be counted on to vindicate the law as private attorneys general. *Id.* at 269-70.

In *Holmes*, the defendant manipulated the stock prices of various companies. Certain broker-dealers purchased shares in the companies with their own funds. When the stock manipulation was uncovered, the share prices dropped. This caused the broker-dealers to incur huge losses. These losses then rendered the broker-dealers insolvent and unable to meet their obligations to certain of their customers. The plaintiff in *Holmes*, the Securities Investor Protection Corporation ("SIPC"), was forced to advance nearly $13 million to cover the claims of the customers of the insolvent broker-

dealers. SIPC then sued the stock manipulators under RICO to recover the amounts that it paid to the broker-dealers' customers.

The Court held that the second-hand injuries suffered by SIPC and the customers of the insolvent broker-dealers (*i.e.*, the non-payment of obligations having nothing whatsoever to do with the stock manipulation) were too remote to support a claim by SIPC under RICO. Such "second step" injuries generally are considered too indirect to support proximate causation because – in contrast to the "first step" injuries suffered by the mutual funds here – they flow "merely from the misfortunes visited upon a third person by the defendant's acts." *Id.*, 503 U.S. at 268.[5]

In *Holmes*, the Court said all three factors weighed *against* a finding of proximate cause. In the present case, the Court of Appeals accepted in reaching its decision that all three factors cut *in favor* of a finding of proximate cause (as, in fact, they do). The Court of Appeals, however, refused to rely on those factors, dismissing them as nothing more than the "underlying premises" of the proximate cause requirement. (5a)

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5. The *Holmes* Court noted that a liquidating trustee, suing on behalf of the defunct broker-dealers, would have been a proper plaintiff to seek redress for the manipulation. 503 U.S. at 273. In this derivative action, Petitioners stand in the shoes of the mutual funds for purposes of the proximate cause inquiry, just as a liquidating trustee would have stood in the shoes of the broker-dealers in *Holmes*.

Contrary to the decision of the Court of Appeals, the *Holmes* factors are more than just the underlying premises of the proximate cause requirement. Since *Holmes*, the Court and the lower courts have relied on the *Holmes* factors to guide the requisite proximate cause enquiry.[6] For example, in *Bridge*, the Court determined, by weighing all three *Holmes* factors, that the defendants' racketeering proximately caused the plaintiffs' injuries even though contributing causes had intervened.

Other Circuits agree that proximate causation under RICO ought to be determined on a case-by-case basis using the *Holmes* factors. For example, in *Newcal Indus., Inc. v. IKON Office Solution*, 513 F.3d 1038 (9th Cir. 2008), the district court dismissed RICO claims on grounds other than the *Holmes* factors. The Ninth Circuit reversed and remanded for the trial court to determine proximate causation under the *Holmes* factors. *Id.* at 1055. *Accord, Williams*, 465 F.3d at 1288; *Steamfitters Local Union No. 420 Welfare Fund v. Philip Morris, Inc.*, 171 F.3d 912, 932-34 (3d Cir. 1999).

Petitioners do not contend that the *Holmes* factors represent an exhaustive list of factors to be considered. The Ninth Circuit has described them as a "non-exhaustive" list. *Mendoza v. Zirkle Fruit Co.*, 301 F.3d 1163, 1169 (9th Cir. 2002). One additional factor that is also relevant to the proximate cause enquiry is foreseeability. *See, e.g., Bridge*, 128 S. Ct. at 2144.

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6. The Court has used the same approach in antitrust cases. *See, e.g., Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519 (1983).

Conversely, not all of the factors will need to be considered in each case. *See, e.g., Hemi*, 130 S. Ct. at 990 (plurality) (discussing only the third *Holmes* factor). Consistent with the Court's precedents, however, the lower courts are not free to disregard all three *Holmes* factors. Nor may they substitute their own alternative tests, particularly when all three *Holmes* factors weigh in favor of finding that proximate cause exists.

The Court of Appeals assumed *arguendo* that all three *Holmes* factors weigh in Plaintiffs' favor and that Petitioners' injuries were reasonably foreseeable. (5a) That being the case, Petitioners' well-pleaded and factually well-supported allegations of proximate cause should have been accepted as true on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 164 (1993).

Instead of relying on any *Holmes* factor – or any other factor ever relied on by the Court – the Court of Appeals based its decision on a misapplication of a rule based on *In re Am. Express Co. S'holder Litig.*, 39 F.3d 395, 400 (2d Cir. 1994). The Court of Appeals interpreted *American Express* as establishing a black letter rule that "proximate causation is lacking under RICO when the harm results from the exposure or disclosure of the RICO predicate activity." (4a)

The *Holmes* Court cautioned that, in the RICO context (as in the antitrust context), "the infinite variety of claims that may arise make it virtually impossible to announce a black letter rule that will dictate the result

in every case." 503 U.S. at 272 n.20, *quoting Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519, 536 (1983). The Court repeated that warning in *Bridge*, emphasizing that proximate cause "is a flexible concept that does not lend itself to 'a black-letter rule that will dictate the result in every case.'" 128 S. Ct. at 2142, *quoting Holmes*, 503 U.S. at 272.

The decision of the Second Circuit suffers from the error that the Court has repeatedly warned against. It applied a mechanical test entirely detached from the considerations associated with the proximate cause analysis required by *Holmes*. *See Anza*, 547 U.S. at 460 (the Second Circuit's alternative "rationale does not accord with *Holmes*").

In *American Express*, shareholders of American Express brought a RICO action against the company's officers and directors for a decline in the price of the company's stock. The decline followed the exposure of a secret scheme by American Express officers to defame a competitor in violation of RICO. The exposure of the defendants' racketeering scheme allegedly harmed the *reputation* of American Express and led to the market's loss of faith in the company's leadership. That purportedly resulted in a decrease in the value of the shares of American Express, which injured the plaintiff shareholders. The Court of Appeals found no proximate cause, saying "the commission of the RICO violations was not what injured American Express. Rather, it was the exposure of those acts that caused the appellants' harm." 39 F.3d at 400.

The result in *American Express* can be reached based on a straightforward application of the three *Holmes* factors. For example, the plaintiffs' theory of injury in *American Express* faced daunting attribution issues crucial in weighing the first *Holmes* factor, 503 U.S. at 269. In contrast, Petitioners' investment losses here are not the collateral results of damaged *reputation* from negative publicity. They are the direct result of the loss of the gambling companies' enterprise value when law enforcement shut down their primary source of illegal revenue.

Unfortunately, the *American Express* court's reference to "exposure" has come to be regarded in the Second Circuit as a black letter rule of law that requires the dismissal of any RICO claim where the injury occurs after a previously secret RICO scheme is exposed, even if (as the Court of Appeals assumed for the purpose of deciding this case) the exposure was merely a foreseeable contributing cause.

Furthermore, the ill-defined and mechanical rule for which *American Express* has come to stand – that RICO proximate causation is always lacking when injury results from the "exposure" or "disclosure" of RICO predicate activity – simply has no application to the facts of this case. Here, the harm was not caused by any "exposure" or "disclosure" of Defendants' racketeering activity (*i.e.*, investing in illegal gambling companies). Petitioners do *not* claim that the gambling companies' stock plummeted because of (or had anything to do with) the "exposure" or "disclosure" of Respondents' investments. The fact of Respondents' investments was not secret; it had been reported in their SEC filings.

The intervening cause of the mutual funds' injuries, as identified by the courts below, was *not* the "exposure" or "disclosure" of *any* illegal activity. According to the courts below, the investment losses were caused not by "exposure" of Respondents' illegal acts but by *law enforcement* against the illegal gambling businesses, which (as predicted in the prospectus of one of the gambling companies) caused the mutual funds to lose "a very substantial part of their investment."

This case therefore is a good example of how courts are led into error when they try to resolve proximate cause issues using mechanical tests contrary to the flexible enquiry required by *Holmes*. The Court should grant certiorari to resolve a split in the Circuits regarding the significance of the *Holmes* factors.

III. The Writ of Certiorari Should Be Granted to Resolve Whether a Plaintiff Who Suffers a Direct RICO Injury Must Satisfy a Stricter Standard of Proximate Cause Than that Required Under the Common Law

Petitioners allege a "first step" RICO injury suffered directly by the mutual funds that is neither contingent on the harm suffered by third parties nor "entirely distinct" from the RICO violations. Nevertheless, the Court of Appeals required Petitioners to satisfy a stricter standard of proximate cause than that required by the common law. In rejecting the application of common law "foreseeability" principles to Petitioners' "first step" RICO injuries, the Court of Appeals decided an important question of federal law contrary to decisions of the Court. Sup. Ct. Rule 10(c). In addition,

the decision of the Court of Appeals conflicts with the decisions of other Courts of Appeals on the same important matter. Sup. Ct. Rule 10(a).

Petitioners submit that RICO proximate cause for a "first step" injury imposes no greater burden on a plaintiff than the common law requirement. Other Circuits have interpreted *Holmes* as mandating the application of common law proximate cause principles – which focus on foreseeability – to cases alleging "first step" RICO injuries. *See RWB Servs., LLC v. Hartford Computer Group, Inc.*, 539 F.3d 681, 688 (7th Cir. 2008); *Trollinger v. Tyson Foods, Inc.*, 370 F.3d 602, 615 (6th Cir. 2004) (a "first step" RICO injury must satisfy the "traditional requirements of proximate cause – that the wrongful conduct be a substantial and foreseeable cause and that the connection be logical and not speculative"); *Mid Atlantic Telecom*, 18 F.3d at 263 (4th Cir. 1994); *Cox*, 17 F.3d at 1399 (11th Cir. 1994) (applying common law principles to RICO proximate cause determination).

Issuance of a writ of certiorari in this case is particularly appropriate in light of the Court's most recent effort to clarify the law in this area. In *Hemi*, 130 S. Ct. 983, a plurality of the Court held that where the plaintiff's injury is purely contingent on the harm to a *third* party caused by a *fourth* party, *see id.* at 990, such a theory of causation moves "well beyond the first step" and cannot meet RICO's requirement for "direct" injury regardless of whether it was foreseeable. *Id.* at 989.

The facts of *Hemi* were critical to the plurality's decision. Hemi was a New Mexico company that sold cigarettes over the Internet to New York City residents.

Such sales were subject to taxes by both the State of New York and the City. Hemi failed to file certain reports with the State pursuant to the Jenkins Act, which required out-of-state vendors such as Hemi to disclose customer information to the states into which they shipped cigarettes. Pursuant to an agreement between the State and the City, the State was obligated to pass customer information it received from Jenkins Act reports to the City so that the City could collect taxes directly from City residents. The City alleged that Hemi's failure to file the required Jenkins Act reports with the State constituted RICO predicate crimes of mail and wire fraud. According to the City, Hemi's racketeering activity not only deprived the State of its ability to collect state taxes on cigarette sales to New York, it also caused the City to lose taxes owed by City residents. The City argued that because the State was unable to pass along Hemi's customer information to the City, the City was deprived of the ability to collect taxes directly from the City's residents. Based on these facts, the *Hemi* plurality declined to

> extend RICO liability to situations where the defendant's fraud on the third party (the State) has made it easier for a *fourth* party (the taxpayer) to cause harm to the plaintiff (the City). Indeed, the fourth-party taxpayers here only caused harm to the City in the first place if they decided not to pay taxes they were legally obligated to pay.

130 S. Ct. at 990.

In reaching its decision, the *Hemi* plurality relied extensively on *Anza*. In that case, a merchant sued its competitor under RICO alleging that it was injured because the competitor failed to charge sales tax and submitted fraudulent tax returns to the State of New York. The competitor was thus able to undercut the plaintiff's price. In finding that the plaintiff had failed to allege proximate causation, the Court explained that "[t]he cause of [the plaintiff's] asserted harms . . . is a set of actions (offering lower prices) *entirely distinct* from the alleged RICO violation (defrauding the State)." *Id.* at 458 (emphasis added). The alleged RICO violation directly caused the State to be defrauded of taxes, not the plaintiff to lose money to its competitor. *Id.*

Unlike in *Hemi* and *Holmes*, Petitioners here do not complain of second-hand injuries "purely contingent" on the harm suffered directly by third parties. *Hemi*, 130 S. Ct. at 989; *Holmes*, 503 U.S. at 271. Instead, Petitioners sue on behalf of "first step" injured parties.[7] There is no party more directly harmed by Respondents' illegal investments than the mutual funds on whose behalf Petitioners sue, and, as accepted by the Court of Appeals (4a), no better situated plaintiff would have an incentive to sue. *See Hemi*, 130 S. Ct. at 990; *Bridge*128 S. Ct. at 2144; *Holmes*, 503 U.S. at 269-70.

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7. The reference to "first step" in *Holmes*, 503 U.S. at 271-272 was based on a quotation from *Associated Gen Contractors*, 459 U.S. at 534, which held that a union could not recover under the antitrust laws for the contingent injury it allegedly suffered by reason of the defendants' coercion directed against third parties. The Sixth Circuit has described these as "passed-on" injuries. *Trollinger*, 370 F.3d at 613-15.

Moreover, unlike in *Hemi* and *Anza*, Petitioners do not complain of injury from causes "entirely distinct" from the underlying racketeering activity. *Hemi*, 130 S. Ct. at 990; *Anza*, 547 U.S. at 458. Rather, government enforcement of the criminal laws could not possibly have caused any harm to the mutual funds had there been no illegal investments "in the first place." *Hemi*, 130 S. Ct. 983. Defendants' predicate crimes therefore were the primary, efficient, and substantial cause of the mutual funds' losses.

The *Holmes* Court relied on "common law" proximate causation within the statutory framework of RICO because of similar language and attendant proximate cause requirements under the antitrust laws. When Congress enacted § 4 of the Clayton Act, § 7 of the Sherman Act read in relevant part: "Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue . . . ." 26 Stat. 210 (1890). Interpreting this language, the Court held that Congress had intended to "incorporate common-law principles of proximate causation." *Holmes*, 503 U.S. at 267, *citing Associated Gen. Contractors*, 459 U.S. at 533-34 & n.29, 536 n.33. The *Holmes* Court therefore concluded that "[w]e may fairly credit the 91st Congress, which enacted RICO, with knowing the interpretation federal courts had given the words earlier Congresses had used first in § 7 of the Sherman Act, and later in the Clayton Act's § 4." 503 U.S. at 268.

The Court has never held that RICO proximate causation for "first step" injuries such as those complained of by Petitioners is any more demanding than

ordinary common law proximate causation. Indeed, the Court explicitly stated in *Holmes* that "our use of the term 'direct' should merely be understood as a reference to the proximate-cause enquiry." *Id.* at 268 & 272 n.20. That enquiry should be guided by the three factors weighed by the Court in *Holmes*, and by other established common law concepts, such as foreseeability, *see Bridge*, 128 S. Ct. at 2144.

Congress expressly provided that the RICO statute is to "be liberally construed to effectuate its remedial purposes," Pub.L. 91-452, § 904(a), 84 Stat. 947 (1970). *See Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 497-98 (1985). There is no basis in the language of RICO or its legislative history, or in the Court's precedents, to impose a more stringent proximate cause requirement than the common law requirement, at least in the case of "first step" injuries. In light of the express Congressional admonition that RICO is to be liberally construed, "[c]ourts should not erect artificial barriers – metaphysical or otherwise – as a means of keeping RICO cases off the federal dockets." *Sun Savings and Loan Ass'n v. Dierdorff*, 825 F.2d 187, 194 (9th Cir. 1987).

The Second Circuit's aberrant and unduly restrictive construction of RICO is contrary to the statutory mandate, the Court's precedents, and the decisions of other Courts of Appeals. Certiorari should be granted to decide the important question whether a plaintiff alleging a "first step" RICO injury must satisfy a stricter standard of proximate cause than that required at common law.

Furthermore, in *Hemi*, the plurality held that principles of foreseeability do not govern RICO proximate cause in the context of injuries that go beyond the "first step." In doing so, however, the plurality broadly suggested that foreseeability may *never* be relevant to RICO proximate cause analysis. *Hemi*, 130 S. Ct. 991 ("[o]ur precedents make clear that in the RICO context, the focus is on the directness of the relationship between the conduct and the harm. Indeed, *Anza* and *Holmes* never even mention the concept of foreseeability"). *But see Bridge*, 128 S. Ct. at 2144 ("foreseeable and natural" consequences of racketeering satisfy proximate causation under RICO). In light of this, it is particularly urgent for the Court to provide authoritative guidance, lest *Hemi* expand beyond "the limit of its logic." B. Cardozo, *The Nature of the Judicial Process* 51 (1921). If left unclarified, the uncertainty regarding whether foreseeability is ever relevant, even in "first step" RICO cases like this one, will sow confusion among the lower courts and lead to more decisions, such as the one below, announcing unwarranted departures from fundamental principles of proximate causation.

CONCLUSION

For all the foregoing reasons, Petitioners respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

THOMAS I. SHERIDAN, III
Counsel of Record
ANDREA BIERSTEIN
HANLY CONROY BIERSTEIN
SHERIDAN FISHER & HAYES, LLP
112 Madison Avenue
New York, NY 10016-7416
(212) 784-6404
tsheridan@hanlyconroy.com
abierstein@hanlyconroy.com

Attorneys for Petitioners